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The Illiquidity Premium Revisited – Can Pension Funds Access this?

EPFIF

PPCmetrics AG

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Benelux Zeist, February 13, 2018

Introduction

Illiquid Asset Investing – A Clear Cut Case?

“American **investors**, particularly those with long time horizons, **pay far too much for liquidity.**”

David F. Swensen, CIO Yale Endowment

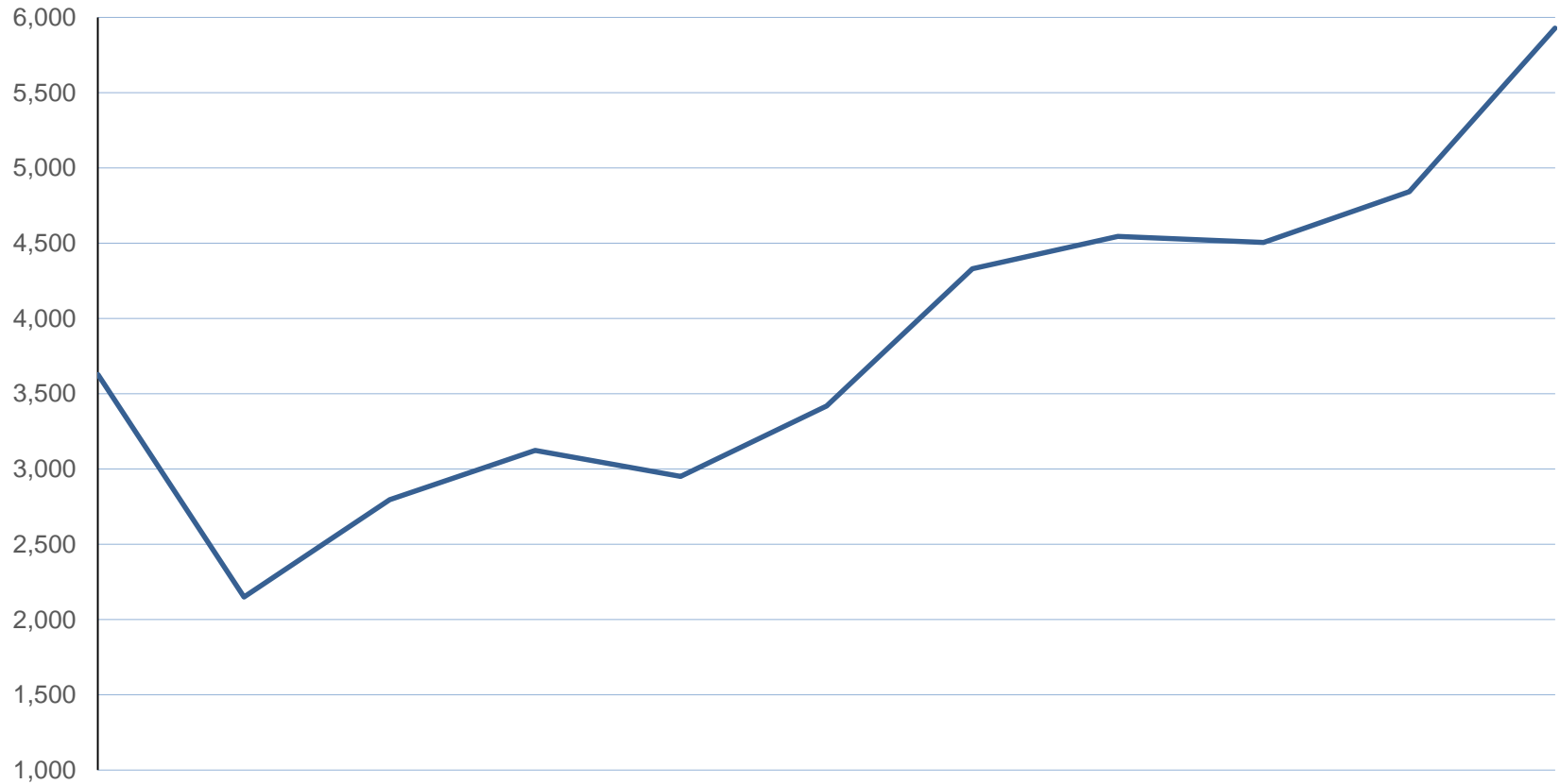
Source: Economist (2000)

Source: <http://investments.yale.edu>

Introduction

Illiquid Asset?

Illiquid vs. liquid assets



Source: Bloomberg, own calculations

Introduction

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Illiquid vs. liquid assets



Source: Bloomberg, own calculations

Introduction

Definition of Illiquid Assets

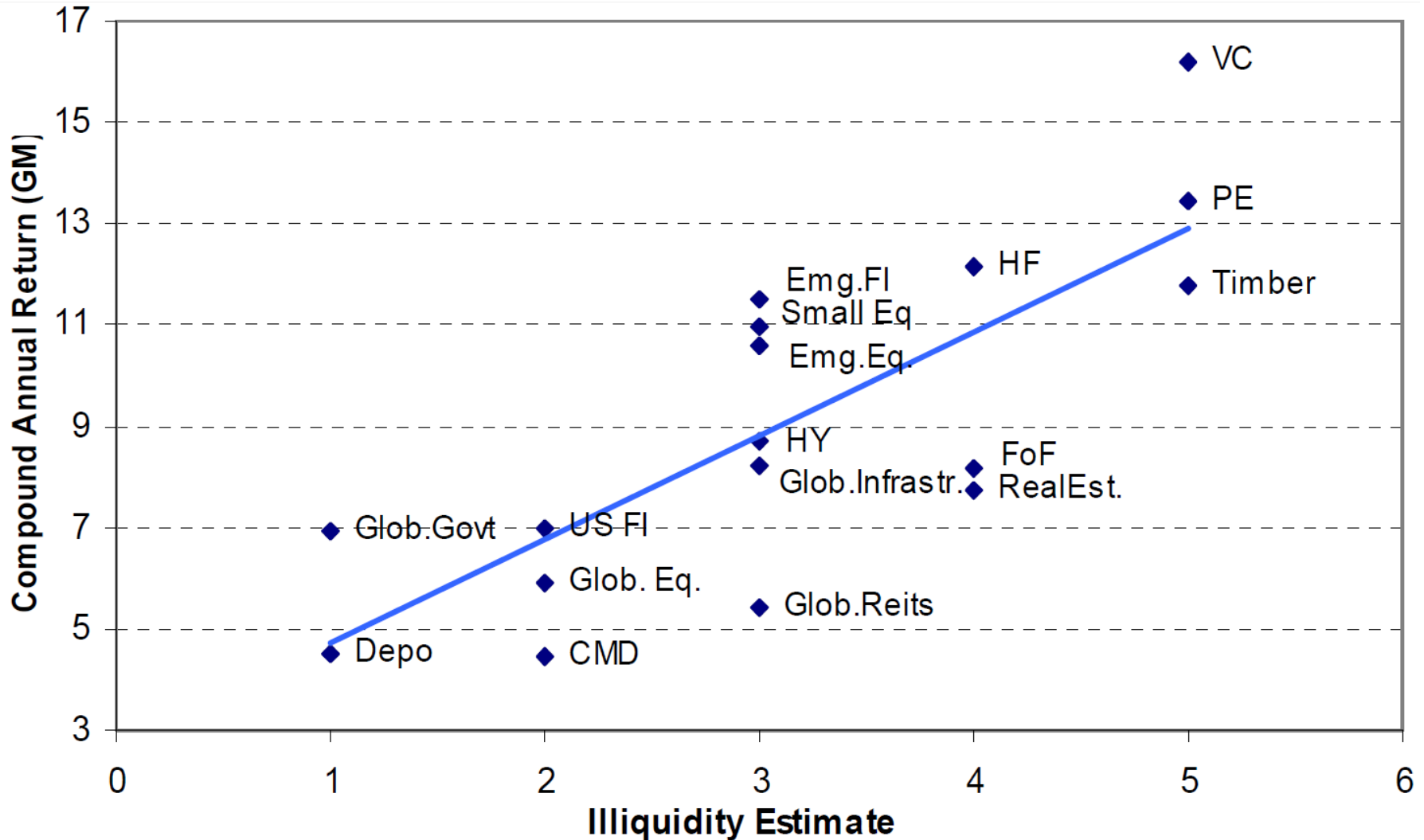
Illiquid refers to the state of a security or other asset that **cannot easily be sold** or exchanged for cash **without a substantial loss in value**.

Illiquid assets may also be hard to sell quickly because of a lack of ready and willing investors or speculators to purchase the asset.

Source: <http://www.investopedia.com>

- As a consequence, investors demand an **illiquidity premium**. What's its **size**? Is it **time-varying**?
- How can pension funds **harvest** this premium?
- Is the **illiquidity premium** beside the obvious illiquidity **a free lunch**?

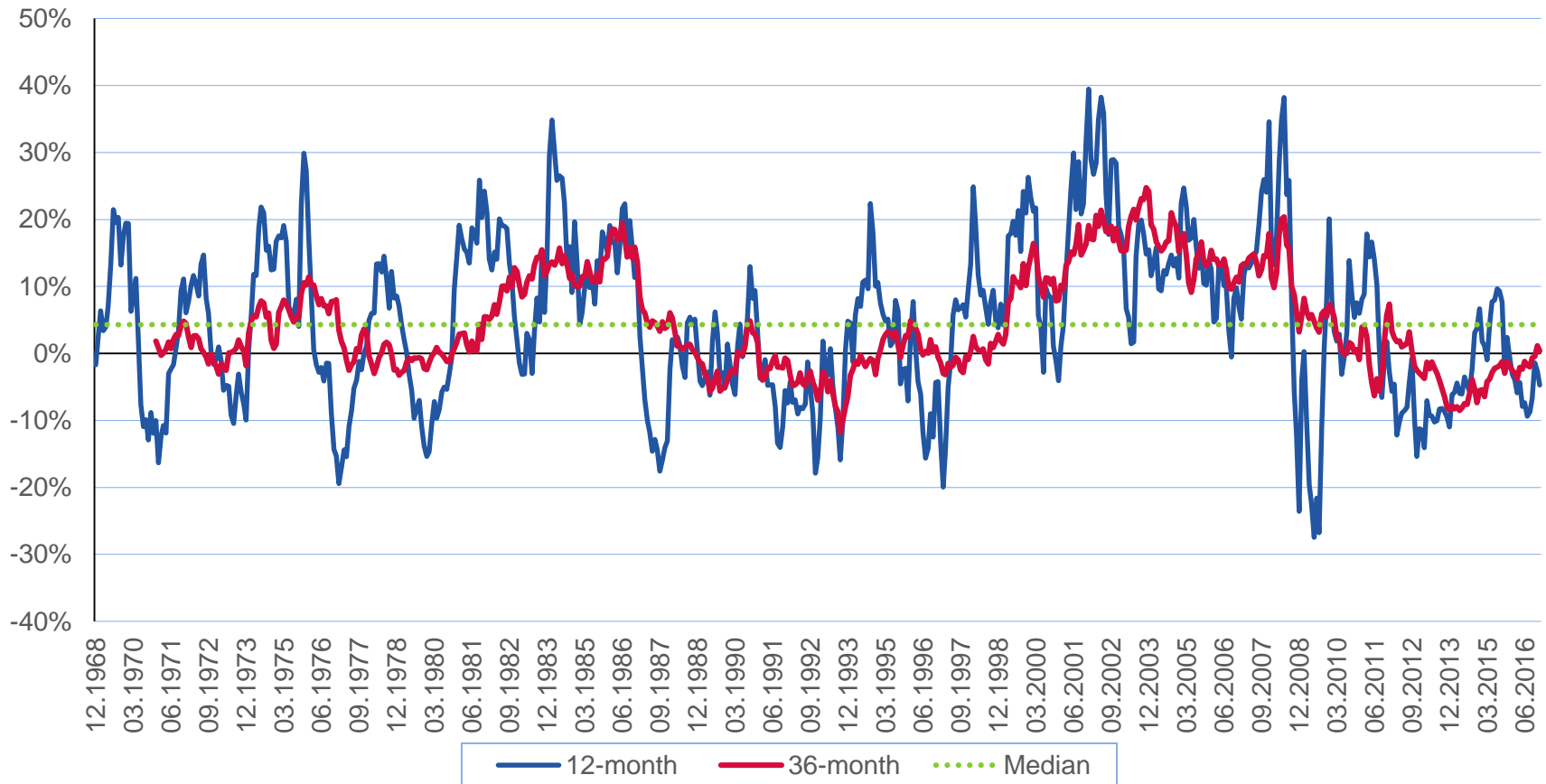
Illiquidity Premium Across Asset Classes



Source: Illmanen (2011)

Illiquidity Premium Time-Varying

Yearly Return on Traded Liquidity



Source: Data from Pastor's Website, own calculations

Appendix

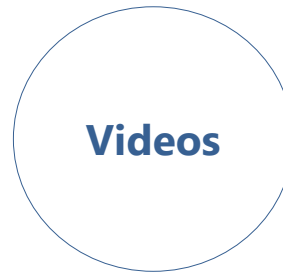
Differences to Liquid Assets

Liquid Assets	Illiquid Assets
Mostly traded in centralized markets	Traded OTC
Easy accessible	Difficult to trade
Small transaction costs	Medium to large transaction costs
Objective and real time value through market pricing	Valuation is subjective and infrequent
Short term investment horizon possible	Long term investment horizon needed
Contracts are standardized and transparent	Contracts are often complex and unique

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